

SIMON FRASER UNIVERSITY
Department of Economics

Econ 345
International Finance

Prof. Kasa
Spring 2014

PROBLEM SET 2
(Due March 20)

The following questions are short answer. 25 points each.

1. Many people have argued that China should allow its exchange rate to become more flexible. Do you think this is a good idea? Describe an example where greater exchange rate flexibility would promote greater output stability. Conversely, provide an example where greater exchange rate flexibility would lead to *less* output stability. Use graphs to illustrate your examples.
2. We showed in class that domestic monetary policy is ineffective under fixed exchange rates. However, we also showed that an *unanticipated* devaluation would be expansionary, at least in the short-run. Explain why in practice policymakers might be reluctant to use devaluation as a short-run stabilization tool. (Hints: (1) Compare and contrast the effects of unanticipated and anticipated devaluations, (2) Consider the effects on other countries.)